

**SUPERIOR COURT OF THE STATE OF CALIFORNIA
County of San Luis Obispo**

DATE: July 23, 2010

DEPARTMENT NO. 9

PRESENT: HON. CHARLES S. CRANDALL, JUDGE

L. Tetley, DEPUTY CLERK

TITLE	COUNSEL
STEVEN ALPERT, et al., PLAINTIFF(S), VS. CUESTA TITLE COMPANY, et al., DEFENDANT(S).	<u>Steven W. Sanchez</u> <u>Samuel D. Ellis</u> <u>Molly J. Baier</u> <u>Jared M. Katz</u> <u>Samuel R. Miller</u>

ACTION NO.: CV 098220

PROCEEDINGS: RULING ON DEMURRERS

Four hundred (400) individual plaintiffs seek redress in connection with investments they made to fund “hard money” construction loans solicited by defendant James Hurst/Hurst Financial for the benefit of defendant-developer Kelly Gearhart and entities controlled by him. The demurring defendants include Cuesta Title Company (“Cuesta”), which served as the escrow agent, Stewart Title of California Inc., and Stewart Title Guaranty Company (which collectively own 80 percent of Cuesta), and Heritage Oaks Bank, which loaned approximately \$1.5 million to Gearhart secured by lots in the Vista Del Hombre property.

The Second Amended Complaint alleges improprieties with respect to a number of construction loan transactions including: Curbaril Santa Rosa Loan Nos. 2004-159 through 2004-167; Salinas River Estates Loans 2004-180-2004-209; Triangle Properties Loans 2006004-2006-018; Beacon Road Loans 2006-069 through 2006-096; All Night RV Loans 2006-122 through 2006-135; and, Vista Del Hombre Loans 2005-035-2005-132, 2005-199 through 2005-223, and 2007-047 through 2007-067.

Among other things, the complaint alleges that Cuesta Title was aware of and participated in the following improprieties regarding these loans:

1. amounts actually deposited in escrow were less than the stated loan amount;
2. individual lots did not exist because parcels were not subdivided into separate lots as promised;
3. escrow funds were improperly transferred to other escrows;
4. escrow funds were not used for stated purposes; and,
5. escrow funds identified as overpayments were improperly returned to Hurst.

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Cuesta's Demurrer

Cuesta demurs to the Fraud, Aiding and Abetting Fraud, and Elder Abuse causes of action. With respect to the fraud causes of action, the general duties and liabilities of an escrow agent are described in *Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002) 27 Cal.4th 705, 711 and *Romo v. Stewart Title of California* (1995) 35 Cal.App.4th 1609, 1618 at Fn. 9. Plaintiffs allege that Cuesta Title had a sufficient degree of knowledge of the improprieties and fraudulent activities involved in the various loan transactions sufficient to trigger its duties to disclose the information to the investors.

As stated, the Second Amended Complaint alleges that numerous false representations were made and that funds were used essentially to perpetuate a Ponzi scheme. There is sufficient specificity of Cuesta's knowledge of alleged improprieties in various transactions to trigger a duty to disclose. Also, there are sufficient allegations of Cuesta's participation in the transactions to establish potential liability. *Compare Citizens of Humanity, LLC v. Costco Wholesale Corp.* (2009) 171 Cal. App. 4th 1, 20-21 (vague allegations insufficient for court to weed out nonmeritorious claims). Moreover, the duty to plead fraud allegations with specificity is somewhat relaxed where, as here, the facts lie more in the knowledge of the opposite party. *Committee on Children's Television, Inc. v. General Foods Co.* (1983) 35 Cal 3rd 197, 217; *compare Citizens of Humanity* 171 Cal. App. 4th at 20-21 (facts of fraudulent scheme held to be within ready knowledge of the plaintiff). The demurrer to the causes of action for fraud and for aiding and abetting fraud are overruled.

Cuesta also contends that the plaintiffs bringing the elder abuse cause of action are not clearly identified as residents of California at the time that the acts occurred. Plaintiffs respond that this cause of action carries the implication that plaintiffs were California residents during the relevant times of the complaint. The Court agrees. The demurrer to the Elder Abuse Cause of Action is overruled.

The Stewart Defendants' Demurrers

Stewart Title of California Inc. and Stewart Title Guaranty Company (collectively "Stewart Defendants") jointly demur to the Second Amended Complaint, which relies upon several theories (including agency, ratification, and alter ego) that would shift responsibility to the Stewart Defendants for the acts or omissions of Cuesta Title.

With respect to the first cause of action for fraud, the Stewart Defendants contend that their own conduct is not alleged in enough specificity. Prior to oral argument, the Court agreed with this assessment. From oral argument, however, the Court now understands that during the relevant time period, Stewart Title of California Inc. acquired Cuesta Title and, further, that Stewart Title Guaranty entered into a written agency agreement whereby, at least with respect to the Heritage Oaks transaction, actions of the Cuesta employees would bind Stewart Title Guaranty. Based on the discussion in oral argument, the facts alleged do suffice to tie in both Stewart Defendants on the fraud charge for purposes of demurrer, whether vicariously or through direct liability. Although the pleadings are certainly not a model of clarity, they are sufficient for purposes of moving this case past the pleading stage. The Stewart Defendants' demurrer to the fraud claim is overruled.

The same considerations discussed above apply with respect to the Aiding and Abetting Fraud Cause of Action. *See Casey v. U.S. Bank National Assn.*, 127 Cal.App.4th 1138. The Stewart Defendants' demurrer to the aiding and abetting fraud claim is overruled.

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With respect to the conspiracy to commit fraud and conversion, the demurrer is sustained with leave to amend. Although the Stewart Defendants are potentially subject to vicarious liability through Cuesta, any specific facts with respect to the direct participation of the Stewart Defendants' employees need to be pled in more detail. *See PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & (2007) 150 Cal.App.4th 384, 396.*

The demurrer to the Elder Abuse Cause of Action is overruled for the same reasons as the Cuesta demurrer.

With respect to negligence, an insured's claim against his title insurer is under the policy, and an insured has no separate claim against a title insurer based on negligence or negligent misrepresentation. *Vournas v. Fid. Nat. Title Ins. Co.*, (1999) 73 Cal. App. 4th 668, 675-676. The rule with respect to issuance of a preliminary title report is the same. *Rosen v. Nations Title Ins. Co.* (1997) 56 Cal. App. 4th 1489, 1499-1500.

At oral argument, plaintiffs' counsel argued forcefully that plaintiff should be granted leave to amend. The Court does not understand how a negligence claim against a title insurer survives in this context, given the holdings in *Vournas* and *Rosen*. Any amended pleading must deal head-on with the apparent bar. The negligence claim directed at the Stewart Defendants is sustained with leave to amend.

The demurrer with respect to breach of fiduciary duty is based upon the contention that plaintiffs' fraud cause of action was not adequately pled. The Court has held otherwise. The demurrer to this cause of action is overruled.

The declaratory relief cause of action does not specifically identify the title policies or the insureds on the policies in question. It does not specifically allege whether claims have been made on policies and whether such claims have been denied. The demurrer on this basis is sustained with leave to amend.

Heritage Oaks Bank demurrer

Plaintiffs allege a cause of action that Heritage Oaks aided and abetted a fraud, and negligence. Plaintiffs allege that Heritage Oaks knowingly aided and abetted a fraudulent scheme to extract equity out of the Vista del Hombre property, and that the bank violated its own internal loan policies when it loaned \$1.5 million to Gearhart.

Liability for aiding and abetting depends on proof of two elements: (1) that the defendant had actual knowledge of the specific primary wrong and that (2) the defendant substantially assisted it. *See Casey v. United States Bank Nat'l Ass'n*, (2005) 127 Cal.App.4th 1138, 1145 (a court must carefully scrutinize whether the plaintiff has alleged the bank had actual knowledge of the underlying wrong it purportedly aided and abetted); *In re First Alliance Mortg. Co.*, (9th Cir. 2006) 471 F.3d 977, 993-994

There is sufficient specificity of Heritage Oaks' knowledge of alleged improprieties in this loan transaction and there are sufficient allegations of its participation in the transaction to establish potential liability. *Compare Citizens of Humanity, LLC* 171 Cal. App. 4th at 20-21 (vague allegations insufficient for court to weed out nonmeritorious claims). Moreover, the duty to plead fraud allegations with specificity is somewhat relaxed where, as here, the facts lie more in the knowledge of the opposite party. *Committee on Children's Television, Inc.* 35 Cal 3rd at 217; *compare Citizens of Humanity* 171 Cal. App. 4th at 20-21 (facts of fraudulent scheme held to be within ready knowledge of the plaintiff). The demurrer is overruled.

With respect to the negligence cause of action, it does not appear that the bank owes any duty to the plaintiffs. “As a general rule, a financial institution owes no duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money.” *Nymark v. Heart Fed. Savings & Loan Assn.* (1991) 231 Cal.App.3d 1089, 1096; *Casey* 127 Cal.App.4th at 1149-1152. The demurrer to the negligence cause of action is sustained without leave to amend.

Counsel are commended for their focused argument. In the Third Amended Complaint, however, plaintiffs should eliminate unnecessary verbiage, state the additional claims succinctly, separate out the bases of liability, and simplify the issues to the extent possible.

Date: July 23, 2010

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Judge of the Superior Court